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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

NO. 999

PRESSED STEEL CAR COMPANY, INC., Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

EARL F. REED,
JOHN E. LAUGHLIN, JR.,
LEE W. ECKELS,
THORP, BOSTWICK, REED & ARMSTRONG,
2812 Grant Building,
Pittsburgh 19, Pa.,
Attorneys for Petitioner.

SMITH BROS. CO. INC., LAW PRINTERS, 432-436 BOULEVARD OF ALLIES, PITTSBURGH, PA.

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COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

The petitioner respectfully prays that a writ of certiorari issue to review a judgment of the United States Circuit Court of Appeals for the Third Circuit entered on December 26, 1945, affirming per curiam a decision of the Tax Court of the United States entered on August 16, 1944.

Summary Statement of the Matter Involved.

(a) THE PROCEEDINGS BELOW.

The opinion of the Tax Court of the United States was entered on August 16, 1944, and is not officially reported. The opinion of the Circuit Court of Appeals was entered on December 26, 1945, and is reported in 152 F. (2d) 280.

(b) THE FACTS OF THE CASE.

This case arises under Section 114(a) of the Revenue Act of 1936, as amended (49 Stat. 1686; 26 U.S.C.A., Internal Revenue Acts, pages 866 *et seq.*). Section 114(a) provides that the basis for the purpose of determining the amount of depreciation allowable as deduction in respect thereof shall be the adjusted basis provided in Section 113(b) of the Revenue Act of 1936 (26 U.S.C.A., Internal Revenue Acts, pages 859 *et seq.*), which latter section provides that such adjusted basis shall, in any case such as that in the case at bar, i.e., a taxable exchange, be the cost properly adjusted for events occurring after the date of the taxable exchange.

In 1936, petitioner, pursuant to a plan of reorganization under Section 77B of the Bankruptcy Act, acquired the assets of a corporation (hereinafter called the "predecessor") then being reorganized under the Bankruptcy Act. Petitioner acquired such assets of the predecessor by the issuance of certain of its securities to the reorganization trustees of the predecessor. Among the securities so issued was a substantial number (30,000) of shares of petitioner's Common Stock which, under the plan of reorganization, the reorganization trustees were required to turn over to an investment

syndicate as compensation for its services in participating in the reorganization.

Petitioner in its Federal income tax return for the taxable year ended December 31, 1936, claimed depreciation with respect to depreciable assets so acquired by it on the basis of an arbitrary value allocated by petitioner's Board of Directors to such depreciable assets and land. Such arbitrary value was the excess of the aggregate of petitioner's liabilities, capital and surplus accounts over the known value of all of its assets other than land and depreciable assets as recorded on its opening balance sheet. In such opening balance sheet the securities which petitioner issued in exchange for the assets of the predecessor corporation were stated at the par value thereof rather than their fair market value on the effective date of the reorganization, which fair market value was substantially higher than the par value and, in consequence, the value (i.e., the cost) allocated to depreciable assets was substantially less than it would have been if the fair market value of such securities rather than their par value had been used in the balance sheet. This resulted in petitioner claiming in its Federal income tax return a much smaller deduction for depreciation that it was entitled to claim under Section 23(n) of the 1936 Revenue Act.

Respondent determined a deficiency in petitioner's income tax liability for the taxable year ended December 31, 1936, in which he recalculated the amount of depreciation allowable as a deduction to the petitioner on the basis of the fair market values of the securities as determined by respondent, viz., $5 per share for petitioner's 5% Cumulative Convertible First Preferred Stock (herein called "First Preferred Stock"), $30 per share for

petitioner's 5% Convertible Second Preferred Stock (herein called "Second Preferred Stock") and $10 per share for petitioner's Common Stock.

On the effective date of the reorganization the common stock of petitioner's predecessor sold on the New York Stock Exchange at a low of $3 per share and a high of $3.25 per share and each share of such common stock of petitioner's predecessor became entitled to receive on the effective date of the reorganization ¼th share of petitioner's Common Stock. Petitioner's First Preferred Stock was convertible into petitioner's Common Stock on a share for share basis and petitioner's Second Preferred Stock was convertible into petitioner's Common Stock on the basis of three shares of Common Stock for each one share of Second Preferred Stock.

Respondent gave effect to the convertibility of petitioner's Second Preferred Stock into Common Stock by valuing Second Preferred Stock at exactly three times the value of the Common Stock but disregarded the convertibility of petitioner's First Preferred Stock into Common Stock on a share for share basis by determining that the value of petitioner's First Preferred Stock was only $5 per share, i.e., 50% of the value of petitioner's Common Stock on the effective date of the exchange.

Respondent also excluded from the cost of the land and depreciable properties acquired by the petitioner, the value of the 30,000 shares of Common Stock which petitioner issued to the reorganization trustees of the predecessor in exchange for the assets of such predecessor.

A Stipulation of Facts, which included the record of sales of the stock of petitioner's predecessor on the

New York Stock Exchange on the effective date of the reorganization and for several months before and after such date, was filed in the Tax Court proceedings and formed the principal part of the evidence before that Court. Included in such Stipulation of Facts were exhibits consisting of the Plan of Reorganization (Exhibit 2-B, R. 73 a-108 a) and the Order of the United States District Court for the Western District of Pennsylvania confirming the Plan of Reorganization (Exhibit 3-C, R. 109 a-141 a). The issuance of the 30,000 shares of petitioner's Common Stock to the reorganization trustees of the predecessor was provided by such Plan of Reorganization, *supra,* and Order Confirming the Plan of Reorganization, *supra.* Petitioner also introduced oral testimony of two expert witnesses who testified as to their opinion of the fair market value on the effective date of the reorganization of the securities, First Preferred Stock, Second Preferred Stock and Common Stock, issued by petitioner in exchange for the assets of the predecessor.

The Tax Court misunderstood the purpose for which the testimony as to the fair market value of the securities and the stipulated evidence as to the selling prices on the New York Stock Exchange of the predecessor's securities, which were convertible into petitioner's securities upon reorganization, were offered. The Tax Court erroneously supposed that the problem before it was to determine the fair market value of the assets for which petitioner exchanged its securities rather than to determine the fair market value of the securities which were issued in exchange for the assets.

In the Stipulation of Facts (R. 35 a-69 a) the respondent's method of determining how much of the fair

market value of the petitioner's securities issued in exchange for the predecessor's assets should be allocated as the cost of land and depreciable assets and the respondent's method of determining how much of such cost so determined should be allocated to each particular class of assets, viz., land, buildings, machinery and equipment, etc., were agreed to be correct.

Because of its fallacious assumption that the question presented to it was to determine the fair market value of the assets rather than the fair market value of the securities from which latter, by means of the concededly correct methods used by respondent (such methods being substantially the same as those used by petitioner in calculating its depreciation in its tax return) the cost of the depreciable assets could be calculated, the Tax Court completely ignored the only evidence which was before it as to the cost of the petitioner's depreciable assets and made its decision upholding the Commissioner's determination without the benefit of any evidence in the record which might conceivably support such decision.

The following excerpt from the opinion of the Tax Court (R. 276 a-277 a) clearly illustrates the Tax Court's complete misconception of the issue before it:

> "Petitioner asks us to fix the fair market value of the transferred assets at $12,500.00. This figure is based on the testimony of two 'expert witnesses' who arrived at their conclusions by various methods of stock valuation but is in no respect based on an appraisal of the physical assets sought to be depreciated. * * * Petitioner's case rests solely on the testimony of the two witnesses. In the process of valuation by petitioner's witnesses, there

was no attempt to segregate the values as to land, depreciable assets, or other assets, or to allocate to each class an appropriate value. The character of the physical assets and rates of depreciation were not taken into account. In fact, no attempt was made to value the specific properties in question. The witnesses were content to give their opinion of value of the stock without tying the same to any specific theory or mathematic process."

The net result of the Tax Court's misunderstanding of the issue, which the Circuit Court countenanced by affirming the decision, is that it deprives petitioner of the benefit of allowable depreciation deductions in computing its Federal income tax liabilities with respect to approximately $5,000,000 of the petitioner's investment (i.e., cost) for depreciable assets. For the taxable year ended December 31, 1936, the depreciation thus lost by reason of the Tax Court's misconception of the issue amounted to approximately $153,000.

Jurisdiction.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, 43 Stat. 938 (28 U.S.C. 347(a)) and Section 1141 of the Internal Revenue Code, 53 Stat. 164 (26 U.S.C. 1141(a)).

Questions Presented.

1. Whether or not such part of the aggregate of the securities issued by a corporation in a taxable exchange for the assets of another corporation as are required by an agreement between the corporation receiving such securities and a third person to be turned over by the corporation receiving such securities to such third person for services in bringing about the exchange constitutes a part of the cost of the assets received in the exchange by the corporation issuing the securities.

2. Whether the Tax Court of the United States having before it stipulated evidence and testimony directly contradictory of a determination (in a formal notice of deficiency) made by the Commissioner of Internal Revenue, there being no other evidence in the record supporting such determination by the Commissioner of Internal Revenue, is entitled to give any evidentiary effect to such determination by the Commissioner of Internal Revenue.

3. Whether the Tax Court, having erroneously assumed that the question before it was one of determining the fair market value of the assets acquired in a taxable exchange on the date such exchange was effected rather than the real question of determining the cost of such assets, and having based its decision upon such misconception of the issue, has exceeded its authority under Section 1111 of the Internal Revenue Code, 53 Stat. 160 (26 U.S.C. 1111) in giving evidentiary effect to a determination of the Commissioner of Internal Revenue, and has thus so far departed from the accepted and usual course of judicial proceedings, which departure has been

sanctioned by the Circuit Court, as to call for an exercise of this Court's power of supervision.

Reasons Relied on for the Allowance of the Writ.

1. The decision of the Circuit Court, affirming the Tax Court, has decided a Federal question in a way which is in conflict with applicable decisions of this Court which hold that the cost of property purchased or acquired in a taxable exchange by a taxpayer is the fair market value of the consideration paid or given by the taxpayer for such property.

2. The decision of the Circuit Court, affirming the Tax Court, has decided a Federal question in a way which is in conflict with decisions of other circuit courts of appeal on the same matter in that the effect of its decision is that where the seller of property agrees to and does pay a commission out of the proceeds of the sale of property, the amount of such commission reduces the purchaser's cost of such property.

3. The decision of the Circuit Court, affirming the Tax Court, sanctioned such a departure from the accepted and usual course of judicial proceedings (in that such decision gives evidentiary effect to a determination of the Commissioner of Internal Revenue in the face of uncontradicted evidence and testimony contrary to the facts determined by the Commissioner of Internal Revenue, there being no other evidence in the record which supports or substantiates the facts determined by the

Commissioner of Internal Revenue) as to call for an exercise of this Court's power of supervision.

Respectfully submitted,

PRESSED STEEL CAR COMPANY, INC.,
Petitioner,

By: EARL F. REED,
By: JOHN E. LAUGHLIN, JR.,
By: LEE W. ECKELS,
Attorneys for Petitioner.

EARL F. REED,
JOHN E. LAUGHLIN, JR.,
LEE W. ECKELS,
THORP, BOSTWICK, REED & ARMSTRONG,
2812 Grant Building,
Pittsburgh, Pennsylvania.